STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission	**:**	
On Its Own Motion	**:**	
-vs-	**:**	
Illinois Power Company	**:**	**02-0721**
	:	
Reconciliation of revenues collected	**:**	
under gas adjustment charges with	**:**	
actual costs prudently incurred.	**:**	

ORDER

By the Commission:

I. INTRODUCTION

On November 7, 2002, the Illinois Commerce Commission ("Commission"), on its own motion, entered an Order commencing this reconciliation proceeding in accordance with the requirements of Section 9-220 of the Public Utilities Act ("Act"), 220 ILCS 5/1-101 et seq. The Order directed Illinois Power Company ("IP") to present evidence at a public hearing depicting the reconciliation of its purchased gas adjustment ("PGA") clause revenues collected with the actual cost of such gas supplies prudently obtained for the 12 months ended December 31, 2002. Notice of the filing of IP's testimony and exhibits in this proceeding was published in newspapers having general circulation in IP's service territory, as prescribed by 83 Ill. Adm. Code 255 and in compliance with the Commission's November 7, 2002 Order in this proceeding.

Pursuant to proper legal notice, a status hearing was held in this matter before a duly authorized Administrative Law Judge of the Commission at its offices in Springfield, Illinois on March 9, 2004. Appearances were entered at the hearing by IP and Commission Staff ("Staff"). Thereafter, an evidentiary hearing was held on June 9, 2004, at the end of which the record was marked "Heard and Taken." No petitions to intervene were received.

At the evidentiary hearing in this matter, testimony of five witnesses was presented. The testimony of Gary Murphy, a Business Leader in IP's Controller's Group, Mark Peters, Manager-Energy Resources for IP's Energy Supply Management Group, and Nancy Gudeman, Manager, Government and Regulatory Affairs (which was changed from Project/Case Manager), was offered on behalf of IP. The testimony of Burma Jones, an Accountant in the Accounting Department of the Commission's Financial Analysis Division, and Eric Lounsberry, the Gas Section Supervisor of the Engineering Department of the Commission's Energy Division, was offered for Staff.

IP is an Illinois corporation with its principal offices in Decatur, Illinois. IP provides electric and gas service to customers in portions of Central and Southern Illinois. In this proceeding, IP presented a reconciliation of the revenues collected under its PGA clause, with the actual costs of purchased gas recoverable under the clause during the reconciliation period. The record also contains a description and review of IP's practices and procedures for procuring natural gas for resale. IP's reconciliation was reviewed by members of Staff. In addition, IP submitted responses to data requests from Staff concerning IP's gas purchasing and storage practices and activities.

II. APPLICABLE REGULATORY STANDARDS

Section 9-220(a) of the Act provides, in part, that the Commission may authorize the increase or decrease in rates and charges based upon changes in the cost of fuel used in the generation or production of electric power, changes in the cost of purchased power, or changes in the cost of purchased gas through the application of a fuel adjustment clause or a PGA clause. This section also requires the Commission to initiate annual public hearings "to determine whether the clauses reflect actual costs of fuel, gas, power, or coal transportation purchased to determine whether such purchases were prudent, and to reconcile any amounts collected with the actual costs of fuel, power, gas, or coal transportation prudently purchased." In each such proceeding, "the burden of proof shall be upon the utility to establish the prudence of its cost of fuel, power, gas, or coal transportation purchases and costs." In the past the Commission has defined prudence as the standard of care which a reasonable person would be expected to exercise under the same circumstances encountered by utility management at the time decisions had to be made.

For gas purchases, the provisions of Section 9-220 are implemented in 83 Ill. Adm. Code 525 ("Part 525"), "Purchased Gas Adjustment Clause." Section 525.40 of Part 525 identifies gas costs which are recoverable through the PGA. Adjustments to gas costs through the Adjustment Factor are addressed in Section 525.50. The gas charge formula is contained in Section 525.60. Annual reconciliation procedures are described in Section 525.70.

III. OVERVIEW OF IP'S PROCUREMENT ACTIVITIES IN 2002

IP witness Murphy sponsored IP Exhibit 1.0 (including all attachments thereto) and IP Exhibit 1.6, Supplemental Direct Testimony, including IP Exhibit 1.7, Revised PGA Reconciliation Schedule Adjusted for Donated Services. Exhibit 1.0 provides, among other things, the reconciliation of total revenues billed to recover the cost of natural gas with the total cost of gas pursuant to the PGA clause for the 12 months ended on December 31, 2002. Mr. Murphy's testimony and exhibits demonstrate the reconciliation of the total costs of gas as expensed on IP's books with the total revenue billed under Rider A and Rider B (for both demand and commodity charges), attributable to the recovery of the cost of gas for 12 months ending December 31, 2002.

The Supplemental Testimony of Gary J. Murphy, IP Exhibit 1.6, and the Revised PGA Reconciliation Schedule Adjusted for Donated Service, IP Exhibit 1.7, were filed to correct the method of accounting for donated service costs and revenues. An error in the way IP reflected donated service costs and revenues in PGA calculations was first addressed in the 2001 PGA Reconciliation case, Docket No. 01-0701. IP worked with Staff to determine the proper method of accounting for donated services and the 2001 PGA Order reflected a reconciliation based upon that method, which removes PGA revenue calculated for donated services customers from total PGA revenue and reduces gas costs by an amount equal to company use therms (which includes donated services) multiplied by IP's weighted average system cost of gas. This method was not reflected in the 2002 reconciliation as originally filed in IP Exhibit 1.1. IP Exhibit 1.7 shows the revised 2002 PGA reconciliation schedule and the change to IP's requested Factor O.

Mr. Murphy also stated that there were adjustments to Rider H, Pipeline Surcharge. IP is no longer incurring take-or-pay and gas supply realignment charges; therefore, the Rider H tariff was revised in Docket No. 02-0456. The revised tariff requires IP to amortize under/(over) -recovery positions on a monthly basis until the balances are immaterial in amount; at which time, the balances are either written off, if an under-recovery position remains, or refunded to an energy assistance program, if an over-recovery position remains.

Mr. Murphy also sponsored attachments which provided the basis for the presentation of IP's annual reconciliation. Specifically, this basis for presentation recites the language from 83 Ill. Adm. Code 525.70 requiring utilities to perform an annual reconciliation. Additionally, Mr. Murphy's attachments include IP's Schedule of Reconciliation Balance for the Adjustment for Pipeline Transition Surcharge, which included data for the books and records that are maintained by IP in the general course of business, and reports from IP's independent accountants, PricewaterhouseCoopers, regarding its examination of IP's Rider H, Pipeline Transition Surcharge reconciliation, and IP's purchase gas adjustment reconciliation of the year ending December 31, 2002.

IP witness Peters sponsored IP Revised Exhibit 2.0. With regard to IP's natural gas procurement activities in 2002, Mr. Peters stated that IP purchased 56.66 BCF of natural gas from various producers and marketers. He said IP reserved firm natural gas supply from those suppliers providing the lowest reservation cost (assuming that commodity prices were equal) for the necessary delivery point. Natural gas to be supplied under these contracts was priced with appropriate market indices. Actual purchases during any period were made from the supplier with the lowest total cost that met the operational needs of the system. In reserving firm gas supplies for the 2002-2003 winter season, IP sought bids from over 38 suppliers. Of those suppliers, 15 returned bids. Eight of those bidders were selected to provide firm supply. IP purchased a portion of its natural gas supply and transportation capacity from an affiliate, Dynegy Marketing and Trade ("DMT"). Commodity purchases from DMT, were made utilizing the same criteria as applied to all suppliers. In 2002, less than 16% of IP's total gas supplies by volume were purchased from DMT.

Mr. Peters stated that IP reserved both base load (required take) and swing (variable take) firm winter gas supplies. IP is not obligated to purchase any gas under swing contracts (though IP has the right to take up to the reserved value under the specified pricing) but instead could meet its commodity requirements by purchasing spot gas from other suppliers.

IP also leased transportation and storage capacity via six interstate pipelines. In general, IP's pipeline facilities do not serve a particular geographic area. However, a portion of IP's load is "captive" to a particular pipeline. Over a period of years, IP has constructed additional pipeline interconnections and transmission facilities between several of these formerly distinct areas. Mr. Peters states this provides IP with flexibility in the selection of resources to serve its load. According to Mr. Peters, maximum pipeline rates and contract terms are approved by the Federal Energy Regulatory Commission ("FERC"). Mr. Peters notes that in many cases, IP has been able to negotiate terms including discounted rates with interstate pipelines.

Mr. Peters stated for 2002, IP determined the pipeline capacity that should be purchased and the firm winter gas supply that should be reserved by designing its supply portfolio so that firm natural gas supply is sufficient to meet requirements on a most severe peak day. For 2002, IP reserved sufficient pipeline capacity and firm winter natural gas supply to serve, along with storage deliverability, the load expected in weather conditions equivalent to the coldest year in the previous twenty years.

Mr. Peters also presented testimony describing suppliers from which IP makes spot purchases. IP solicits offers to provide gas services and commodities from eligible suppliers. To maximize the number of eligible suppliers, IP actively seeks to expand the number of suppliers with whom it has entered into a necessary enabling agreement (such as the North American Energy Standards Board agreement). For those transactions which cover longer term periods, as in the case of securing winter supply requirements, IP will actively solicit interest from this list of suppliers and those with whom IP has begun the process of establishing an enabling agreement. For those transactions of shorter duration, such as a daily supply, IP both solicits interest from those suppliers known to be capable of meeting the specific need and received unsolicited offers from suppliers. Mr. Peters also stated that IP had frequent discussions with suppliers in which it provided a general overview of its anticipated needs for the purpose of generating interest and increasing the response to future solicitations. Mr. Peters stated that the type of contract that IP typically used is the industry-standard enabling agreement contract forms that have been developed by the Gas Industry Standards Board and the successor North American Energy Standards Board.

Mr. Peters testified that for the 2002 reconciliation year, IP purchased some of its gas supply under a price volatility mitigation program. IP purchased approximately 31.5% of its total forecasted gas supplies for the months of January, February, and March, under forward fixed price contracts, pursuant to a plan to make a portion of its purchases using fixed price purchases to provide some stability to the PGA. For the months of November and December, IP reserved firm supply, with the movement in price limited by a price collar for base load reservations secured at a monthly index and a price cap for swing supply reservations secured at a daily index. Mr. Peters went on to define a price cap and a price collar.

Mr. Peters stated that IP believed that in order for such purchases under a price volatility mitigation program to be deemed prudent that (1) IP would have to develop a well thought out plan, (2) the plan would need to be followed through on, and (3) most importantly, that at the time that these purchases were made that IP bought the gas at the least cost available, for that specific contract, for similar terms and conditions which met IP's operation needs and considerations.

Mr. Peters testified that IP believed that its price volatility mitigation plan was well thought out and that IP did follow through with those plans. He stated that IP, as did many other market participants in the State, recognized the concerns of its customers as well as the Commission with the extreme volatility and price levels experienced during the 2000-2001 heating season. IP participated in different public forums and information processes on this topic, including those convened by the Commission. IP discussed securing 20 – 30% of its commodity portfolio through the forward purchase of physical gas for the 2001-2002 heating season. IP also had access to various industry communications regarding price and supply forecasting and recognized there was a real possibility that the pricing and price volatility experienced in the 2000-2001 heating season could reoccur. Mr. Peters stated IP developed a plan to stabilize its gas acquisition costs and mitigate the volatility in the PGA such as that which was experienced in the 2000-2001 heating season. Mr. Peters also mentioned that following the 2001-2002 heating season, IP reviewed this plan and made adjustments to incorporate the benefit of its experiences. Mr. Peters stated that IP met with the Staff of the Commission to discuss its plan and solicit feedback.

Mr. Peters described how the amounts to be acquired under these plans were determined. He stated that for both the 2001-2002 plan and the 2002-2003 plan, IP reviewed its load and demand forecasts and its storage field deliverability to help determine the amount of gas that IP would purchase under a normal weather winter scenario. Discussions were then held within IP's Gas Supply organization to determine an appropriate percentage of this non-storage gas that should be purchased on a fixed price forward basis in order to mitigate potential heating season price volatility. This percentage was determined based upon two primary considerations: (1) the amount of IP's overall supply requirements which it was felt should be exposed to spot market pricing and (2) any operational constraints which would be presented in a warmer than normal winter, if more gas were contracted for than what could be used.

Mr. Peters stated that for the 2001-2002 plan, IP considered the use of financial futures contracts as well as the purchase of physical forward gas. It was determined that the purchase of physical forward gas was better suited for this purpose. IP then developed a plan to acquire the targeted levels of gas in a manner which would reduce exposure to market price for the contract at a specific point in time, by purchasing tranches over a three month period.

Targeted volumes were allocated across pipeline receipt points based on operational needs, but in sufficient quantities to attract supplier interest. These purchases were scheduled for the first of April, May, and June. These dates were chosen to complement the normal purchases made for storage field injections, effectively averaging the forward commodity cost of the 2001-2002 heating season supply over the period of April 2001– October 2001. IP developed and issued a Request for Proposal for each tranche, on each pipeline, at the desired point of receipt onto the pipeline. Proposals were then gathered and reviewed for suitability, prices were compared, and the best offers were accepted. As a result of this process, IP purchased these supplies at the lowest price available on the day the purchase was made.

Mr. Peters went on to describe the 2002-2003 plan. He stated that IP revised its plan to utilize price collars and price caps to mitigate price volatility rather than fixed priced purchases. It did so after a review of the 2001-2002 program and consideration of other mitigation tools.

IP developed a plan to acquire the targeted levels of gas in a manner which would reduce exposure to market price for the contract at a specific point in time, by purchasing tranches over a three month period. The program was developed to ensure sufficient diversity to avoid potential oversupply on any specific pipeline and in sufficient quantities to attract supplier interest. These purchases were scheduled to be accomplished by the first of July, August, and September. IP developed and issued a Request for Proposal for each tranche, on each pipeline, at the desired point of receipt onto the pipeline. Proposals were then gathered and reviewed for suitability, prices were compared, and the best offers were accepted. As a result of this process, IP purchased these supplies using the criteria specified in the plan. Collars were awarded to the supplier with the lowest floor for a corresponding, prespecified cap for a given receipt point. Caps were awarded to the supplier with the lowest reservation fee for a given receipt point.

Mr. Peters testified that the 2001-2002 plan was modified because while the 2001-2002 plan met its goal of reduced price volatility and the avoidance of oversupply, it was felt that an opportunity existed to improve the program. Specifically, the use of fixed price supply, while providing certainty of pricing and avoiding the impact of price spikes, does result in some loss of opportunity to enjoy the benefit of volatility when prices fall. Additionally, fixed price forward purchases are all must take volumes. In the event of a warmer than normal season, issues of potential oversupply arise as do issues regarding the ratio of these fixed purchases to the total purchases.

Mr. Peters stated that IP utilizes storage primarily for purposes of reliability. However, it was also recognized that the normal operation of storage (summer injection/winter withdrawal) provides a price volatility mitigation which is very similar to a fixed price purchase. By utilizing tools other than fixed priced purchases for the 2002-2003 program, a greater diversity in mitigation tools was achieved.

Mr. Peters testified as to IP's other sources of supply in 2002. IP purchased 30,198 MMBtu, or less than 0.001% of total purchases, from one intrastate production field. This field changed ownership in 2002. IP purchased gas from both owners during the reconciliation year. Mr. Peters also stated that IP does not use synthetic gas derived from naphtha, propane, or liquefied natural gas to augment its natural gas supplies.

With regard to the use of storage fields and services, IP owns and operates seven underground gas storage fields. IP's storage fields had a maximum rated daily withdrawal capacity of approximately 342,000 MMBtu/day for the reconciliation year. In addition, IP augmented its storage capacity by leasing storage services from a total of three interstate pipelines. Mr. Peters also testified that IP transported more than 26.65 BCF of customer-owned gas in 2002.

IV. STAFF'S POSITION

Staff witness Jones stated that Staff reviewed IP's filing, performed a field review, and reviewed IP's responses to data requests concerning the revenue collected and costs recoverable under the PGA clause. She indicated that Staff found no reason to object to IP's reconciliation of revenues collected under the PGA clause with actual costs as shown in the Appendix hereto. Ms. Jones noted that IP included $1.63 in interest charges in recoverable gas costs for the 2002 reconciliation year. Given the immateriality of the amount and the fact that there were no other adjustments, she did not propose an adjustment in the instant proceeding. However, IP should not construe the lack of an adjustment in this proceeding as the basis for including late payment charges (interest charges) in recoverable gas costs in future proceedings.

Staff witness Lounsberry also testified that Staff reviewed IP's filing and responses to numerous data requests concerning the prudence of IP's gas purchases during the reconciliation period. He indicated that Staff found no reason to dispute IP's assertion that all its gas supply purchases during that period were prudently incurred.

V. FINDINGS AND ORDERING PARAGRAPHS

The Commission, having considered the entire record herein and being fully advised in the premises, is of the opinion and finds that:

(1) IP is engaged in the business of furnishing gas and electric service to the public in the State of Illinois, and is a public utility within the meaning of the Act;

(2) the Commission has jurisdiction over IP and the subject matter herein;

(3) the findings of fact and conclusions of law set forth in the prefatory portion of this Order are supported by the record herein and are hereby adopted as findings of fact and conclusions of law;

(4) the evidence shows that for the calendar year 2002 reconciliation period, IP acted reasonably and prudently in its purchase of natural gas;

(5) the approved reconciliation of revenues collected under IP's PGA tariff with the actual cost of gas prudently purchased for the calendar year 2002 reconciliation period is set forth in the Appendix to this Order; and

(6) IP should implement a Factor O refund of $11,439 for Rider A customers, $0 for Rider B Demand customers, and recoveries of $45,497 for Rider B Commodity customers in its first monthly PGA filing after the date of this Order.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that the reconciliation of revenues collected under Illinois Power Company's PGA tariff with the actual cost of gas prudently purchased for calendar year 2002, as set forth in the Appendix hereto, is approved.

IT IS FURTHER ORDERED that Illinois Power Company shall comply with Finding (6) of this Order.

IT IS FURTHER ORDERED that subject to the provisions of Section 10-113 of the Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

By order of the Commission this 21st day of July, 2004.

(SIGNED) EDWARD C. HURLEY

Chairman